UNITED
NATIONS

TD

United Nations Conference
on Trade and Development

Distr.
GENERAL

TD/B/CN.4/15
9 December 1992

Original: ENGLISH

TRADE AND DEVELOPMENT BOARD
Standing Committee on Developing Services
Sectors: Fostering Competitive Services
Sectors in Developing Countries
Insurance

[INSURANCE]

First session
Geneva, 1 February 1993
Item 3 of the provisional agenda

ESTABLISHMENT OF THE WORK PROGRAMME OF THE STANDING COMMITTEE ON DEVELOPING SERVICES SECTORS: FOSTERING COMPETITIVE SERVICES SECTORS IN DEVELOPING COUNTRIES: INSURANCE

Issues for consideration in the establishment of the work programme on insurance

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GE.92-53161 (E)

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I. INTRODUCTION

1. The eighth session of the Conference held at Cartagena in February 1992 resolved to give a new direction to the work of UNCTAD. This is expressed in the Cartagena Commitment. It was decided to suspend the existing main Committees of the Trade and Development Board, including the Committee on Invisibles and Financing related to Trade (CIFT), one of whose two regular sessions was devoted to insurance. According to paragraph 72 of the Cartagena Commitment the work on insurance is to be incorporated in the newly-created Standing Committee on Developing Services Sectors: Fostering Competitive Services Sectors in Developing Countries.

2. At the second part of its thirty-eighth session held from 21 April to 7 May 1992, the Trade and Development Board established the terms of reference for the Standing Committee on Developing Services Sectors. While the general terms of reference for the Committee apply also to insurance, paragraph 4 of those terms of reference asks the Committee "to analyse prospects for developing and strengthening the insurance sector and enhancing the trade of developing countries in this sector".

3. As regards the work programme in the field of insurance, many of the issues relevant for the development of a viable insurance sector have been taken up over the years, as insurance has been a part of UNCTAD's work since its establishment. Numerous studies have been carried out which deal with the problems of the domestic insurance sector of developing countries and issues of international trade in insurance services. Pertinent resolutions and recommendations have been adopted by the CIFT sessions on insurance which used to meet regularly about every two or two-and-a-half years. Technical assistance activities in insurance have also provided valuable insights and information. In establishing its work programme on insurance, the Standing Committee may wish to take the prior work in insurance into account.

II. PROGRESS ACHIEVED BY THE INSURANCE SECTOR OF DEVELOPING COUNTRIES

4. By the end of the 1970s, almost all developing countries had created national insurance markets. A great majority of developing countries had established domestic insurance companies, adopted a legal framework regarding insurance and had introduced administrative procedures to ensure its application.

5. Insurance markets of developing countries differ markedly from each other: there are many markets on which foreign and domestic companies and, among the latter, both public and private domestic companies, compete; other insurance markets have not allowed entry of foreign companies, either as domestically registered companies or as branches, but several or many domestic companies operate on a competitive basis; again other insurance markets are monopolistic markets and a public insurance company conducts all insurance and reinsurance operations. Many developing countries have established domestic reinsurance companies, very often in public hands; most of these receive compulsory cessions from local direct insurers. The developing countries where companies operate in a competitive setting have usually established a central authority for insurance supervision.

6. Today most developing countries underwrite most of the common risks of their own markets by companies either owned by domestic capital or locally registered. The range of insurance covers has consistently been broadened and a great variety of producer and consumer services are now being offered. While the larger insurance markets cover risks of a more specialized nature as well, many of the target risks and those of a sophisticated and highly technical nature are placed abroad, either directly or, frequently, via reinsurance. Risks of a catastrophic nature are also largely insured abroad.

7. Developing countries have also made noteworthy advances in the development of human resources for insurance. Many countries have established their own insurance training institutes, the more developed ones offering advanced professional courses on insurance and management. Countries with less developed insurance markets, however, still depend on having their staff trained overseas or locally through cooperation with foreign insurance institutions.

8. The insurance markets of developing countries have made great advances in building up cooperation with insurance markets of other developing countries. Regional insurance organizations exist in Africa, Asia and Latin America; in Africa the African Insurance Organisation (AIO) includes a majority of insurance companies and supervisory authorities of the continent; in Latin America members of the Federación Interamericana de Empresas de Seguros (FIDES) are private insurance companies; for Arab countries the General Arab Insurance Federation (GAIF) exists. In Asia there is the East Asian Insurance Congress (EAIC) in which insurance and reinsurance companies, supervisors and brokers of 11 countries participate. Interregional links are also fostered through the Federation of African and Asian Insurers and Reinsurers (FAIR) and the Third World Insurance Congress (TWIC). Also on the level of supervisory authorities links have been established on a regional or subregional basis.

9. On the operational level, cooperative mechanisms have been instituted, particularly in reinsurance. On a regional basis, both Africa and Asia have a regional reinsurer, the African Reinsurance Corporation and the Asian Reinsurance Corporation respectively. Subregional reinsurers also exist, as for example CICA Re for French-speaking Africa, Zep Re for the Preferential Trade Area (PTA) countries of eastern and southern Africa, ASEAN Re for the ASEAN region. These corporations have been established to promote the diversification and spread of regional business and increase the retention capacity of the region. In addition, a number of subregional and regional pools are operating for specific lines.

10. The respective subregional, regional or interregional associations organize regular insurance meetings in one of the member countries. As regards the most universal of these organizations, the TWIC, the meetings are held alternatively in each developing region. The various meetings are attended by a great number of insurers, reinsurers, brokers, and other insurance-related trades of developing countries as well as by representatives of developed countries. They provide a place where contacts can be established, experiences exchanged, innovations introduced and new strategies discussed. Since insurance by its very nature depends on the spreading of risks it is characterized by an international outlook and a great deal of cooperation takes place between the developed and the developing country markets and the various agents active in them.

III. WEAKNESSES CHARACTERIZING THE INSURANCE SECTOR OF DEVELOPING COUNTRIES

11. Despite the great progress achieved over the last three decades, the insurance sector of developing countries still shows many features that characterize an infant industry.

12. Insurance markets are small, due not only to low incomes but also to a lack of insurance awareness among the population. Companies are often undercapitalized, which prevents them from retaining a reasonable portion of the larger risks arising in their countries. Consequently, a great deal of the insurance business written in developing countries is ceded abroad. Even if a good proportion of the business is given to the domestic reinsurer following the requirements of compulsory cessions or the leadership role of the national reinsurer, the latter often does not have the capacity and/or expertise to retain much for its own account. As a consequence, dependence on overseas reinsurance is heavy. As a corollary, the outflow of foreign currency for the purchase of insurance or reinsurance is still relatively high. Developing countries on their part have been unable to take on sufficient reinsurance business from the developed countries. In recent years their acceptance of such business even seems to have decreased.

13. Many insurance markets still lack qualified personnel, particularly personnel with technical and specialized skills. Manpower for technical tasks and for auxiliary services to insurance operations, such as risk identification, assessment and control, loss and claims assessment, and actuarial sciences, are still in very short supply or lacking altogether; this applies in particular to actuaries. Moreover, the requisite statistical data for a sound underwriting have not yet been built up in a large number of developing countries or are not regularly updated. There are still few regional training institutes that could provide higher level training. Such training deficiencies prolong the dependence of companies on overseas technical services and have consequences for the competitiveness of third world insurers and reinsurers which have to compete with their foreign counterparts; it affects their ability to assess and rate their risks properly for maximizing retention.

14. Regulatory authorities in particular lack skilled staff who would be able to supervise the application of the insurance laws and regulations effectively and to monitor company solvency. Often the few skilled personnel there are leave for the better paid jobs in private industry.

15. Despite the existence of many formal and informal contacts among insurers and reinsurers of developing countries and mechanisms for the exchange of more insurance business among them, the amount of such business exchanged still represents only a very small portion of total reinsurance business. The full potential of regional and subregional reinsurers is not adequately used. Business given to subregional and regional pools also is small. This implies that the retention capacity of developing regions is not optimally exploited.

16. Another weakness which affects insurance is the inadequate risk management in many developing countries. Sound risk management holds down economic losses, and this implies reduced claims for insurers which in turn may permit a reduction in premium rates. This could lead to an expansion of insurance business. In the developed countries the insurance industry has

traditionally had a major influence on the introduction and evolution of proper risk management in fields in which it is engaged. In most developing countries the insurance industry does not yet perform such a leadership role.

17. In recent years, the privatization of insurance enterprises and a liberalization of insurance markets to varying degrees have been creating new challenges for the insurance industry of developing countries. Both pose new problems to insurers and Governments alike and can be expected to lead to profound changes particularly on insurance markets that were characterized by a public insurance monopoly or conditions of oligopolistic competition, as well as on markets that were closed to foreign competition.

IV. PROBLEMS THAT MIGHT DESERVE PRIORITY ATTENTION

18. In the light of parts II and III, the Committee may wish to consider whether action on the following issues should be initiated or pursued.

A. Adaptations in insurance regulation and supervision

19. As the insurance industry of developing countries matures, new potentials and concerns are arising. At present, the major emphasis is placed on improving the performance and efficiency of insurance markets, inter alia by introducing a greater degree of competition. In this context the privatization of insurance enterprises and a certain opening of insurance markets to foreign suppliers together with some deregulation are actively pursued by many countries. More importance is also given to the protection of policy holders and other beneficiaries of insurance.

20. Privatization and liberalization are rapidly transforming the structure of the insurance markets in developing countries and are raising new policy issues for both insurance enterprises and government. With the shift from monopolistic and oligopolistic to competitive markets many countries need to adapt their insurance regulatory framework. In this context, issues of prudential regulation and of consumer protection are acquiring greater relevance. Countries have also to improve the capacities and effectiveness of their control authorities whose monitoring and supervisory tasks will increase in complexity and importance. Furthermore, the liberalization of markets will call upon supervisory authorities to ensure that such principles as the rules of establishment, national treatment, non-discrimination and transparency be respected and that no violations of competition occur. A greater degree of transparency regarding the insurance regulatory framework will be required. With many new insurance companies entering the market, supervisory authorities also have to monitor that insurance contracts - which demand payments in return for a promise of indemnification if a certain event were to occur - are honoured when claims arise and that professional competence and integrity are ensured. The concern for greater efficiency of markets further demands that covers are devised that are better able to meet the needs of producers and consumers; here too supervisory authorities can provide support.

21. The Committee might consider examining issues arising in the field of insurance regulation and supervision as a consequence of these developments. In this context innovative regulations dealing with the new challenges recently emerging in some developing countries as well as the regulatory framework existing in those developing countries which have a long experience

with competitive and open insurance markets could be analysed. The ongoing discussion on improvements in prudential insurance regulation in the developed countries would also be of relevance in this context. Conceptual as well as practical aspects of supervision could be considered. Analysis of current issues and problems of supervision and a review of recent developments would increase transparency in this field.

B. Expansion of domestic insurance markets: providing insurance covers for agricultural production and the rural population

22. An increase in the efficiency of insurance markets also demands an expansion of those markets. The domestic insurance markets of most developing countries are narrow, as insurers lack a broad base of clients for the normal risks linked to the latter's productive activities and the vagaries of life. Insurance is based on the law of large numbers and only a sufficiently large number of risks with similar characteristics will provide balanced portfolios. New companies can be expected to enter the insurance markets of developing countries, thereby increasing the extent of competition. New ways for market expansion must therefore be explored.

23. So far, insurance companies of developing countries have largely concentrated their efforts on providing covers for the industrial and urban sectors of their economies. As regards producer services they are primarily covering risks associated with manufacturing activities, infrastructural investments, modern service industries, import and export trade, road transport and risks affecting the urban population associated with these activities. But since in a majority of developing countries a large percentage of the population is based in rural areas, or is in one way or the other connected with productive activities undertaken in rural areas, these areas should be explored in view of their potential for insurance absorption. This applies particularly to agricultural production.

24. So far, insurance penetration in rural areas has been low both in terms of producer and consumer services. There exist few covers for agricultural production, or covers that are attractive and affordable for rural consumers. Most insurance companies of developing countries are based in capital cities and have few outlets in rural areas and small towns. The existence in rural areas of some traditional forms of insurance proves, however, that there is a latent demand. The break-up of traditional family support structures also increases the relevance of modern forms of insurance.

25. Activities in rural areas in need of insurance covers include those in the agricultural sector proper, concerning the production and marketing of agricultural produce (staple and cash crops, livestock, poultry and fish farming) and agricultural commodities produced mainly for export (tea, coffee, cocoa, sisal, jute, etc.), and activities undertaken in the informal production and services sector linked to agriculture and rural consumers (the first processing stages of agricultural commodities, various productive activities and services required by agricultural producers and consumers in rural areas). For many of these activities suitable covers could be developed or existing covers adapted and improved. Marketing of the covers would need to be adjusted to the characteristics of farmers and the rural population.

26. Productivity in the agricultural sector and the informal sector connected with it is still low. However, in practically all developing countries both the agricultural sector proper and the part of the informal sector which is linked to it include areas where new economic activities are under way and productivity is rising. Government and overseas donors are giving growing attention to the development and revitalization of the agricultural sector, and as a result the greater part of it is entering the monetarized economy. More attention is also given to upgrading the productive potential of the informal sector. Financial services, such as appropriate banking and insurance services, can give important support to these efforts, particularly if they are undertaken in close concertation.

27. In order to foster an expansion of domestic insurance markets in developing countries it would seem worthwhile to identify the productive potentials and the specific insurance needs in areas not yet reached by insurance. Market penetration could start by the development of covers for the more productive sectors of the rural and informal economy, which will offer scope for commercially oriented insurance schemes. Development of suitable covers to meet the requirements of relatively large segments of the productive population in rural areas could help to expand the small insurance markets of developing countries, and establish a broader base of risks which are technologically less sophisticated and do not need so much foreign currency when claims arise. A greater number of identical risks would also bring a better balance to insurance portfolios. The similarity of climate and agricultural production, of rural habits and traditions among neighbouring developing countries would also provide a good basis for more mutual cooperation among these countries.

28. The Standing Committee could initiate a more detailed analysis of agricultural insurance potential and of the experiences acquired in this field. As regards the area of livestock insurance in particular, little in-depth research has so far been carried out, despite the fact that a large number of insurers in developing countries have in recent years developed covers for such risks. But further work in agricultural insurance might not be limited to livestock insurance but cover other areas as well where the need for suitable covers is expressed or experience with such covers is available. The potential of cooperation between agricultural insurance and rural credit schemes and institutions in particular could be further explored in view of the synergy effects between them. Developing countries might be interested to make submissions regarding the agricultural insurance covers offered in their countries and their linkages to agricultural development strategies and rural credit. The constitution of an expert group on these issues might also be considered.

29. As called for in paragraph 3 (d) of resolution 33 (XIII) of CIFT, the Insurance Programme has prepared a background study on agricultural insurance in developing countries. The study discusses insurance covers for a variety of productive activities in agriculture, notably crop, livestock and poultry insurance and aquaculture. It also discusses the possibilities of increasing the provision of consumer services to the rural population, such as life and property insurance.

30. A group of experts on agricultural insurance, meeting on 28 and 29 January 1993, is to consider the study and its inputs will be submitted to the session on insurance of the Standing Committee on Developing

Services Sectors: Fostering Competitive Services Sectors in Developing Countries. The Standing Committee could consider whether work in this area should be pursued. Further work on the issue of agricultural insurance and insurance covers for rural markets would be in conformity with paragraph 1 (c) of the terms of reference of the Standing Committee, which requests the Committee, inter alia, to focus on "...producer services related to primary and manufacturing sectors...".

C. Review of insurance and reinsurance in developing countries

31. The terms of reference of the Standing Committee on Developing Services Sectors request the Committee, in paragraph 1 (a), to focus on a "review of the development of services sectors in developing countries and comparative analysis of policies, including identification of domestic weaknesses and capabilities, aimed at creating the conditions necessary for the development of competitive service sectors and export of services".

32. Since the 1970s the Insurance Programme has prepared on a regular basis a review of developments in the insurance sector of developing countries. The Standing Committee could consider how the requirements of paragraph 1 (a) of the terms of reference with regard to a review and comparative analysis might best be met in the future. Pending a decision, the Secretariat has prepared a review of developments in insurance and reinsurance in developing countries in 1989-1992, in accordance with the existing guidelines.

D. Statistical survey of insurance and reinsurance operations in developing countries

33. Since 1987 the secretariat has been publishing a collection of statistical data on insurance and reinsurance operations, based on information supplied by supervisory authorities of developing countries. A new compilation is in preparation and should be available in the first half of 1993. The survey relies on data supplied by 99 developing countries and covers the years 1986 to 1990. The collection and presentation of the statistics are in conformity with the UNCTAD "unified international system of insurance statistics". So far UNCTAD is the only organization to issue a fairly comprehensive collection of statistics relating to the insurance operations of developing countries.

34. The terms of reference of the Standing Committee request the Committee, in paragraph 2 (f), to focus on "collecting and disseminating statistics on trade in services in areas where such collection or dissemination is not being undertaken by other international organizations, and defining ways to improve such collection and dissemination".

35. The Standing Committee could consider how the requirements of paragraph 2 (f) might best be met.

E. Technical assistance activities

36. The secretariat has regularly provided technical assistance on insurance matters to developing countries at their request. Such assistance has usually been financed by UNDP IPF funds. The Standing Committee might wish to identify areas in which technical cooperation should be strengthened in line with paragraph 11 of its terms of reference.

V. ORGANIZATION OF WORK

37. In establishing its work programme, the Standing Committee at its session on insurance would also need to take decisions involving:

- the timing of future sessions;

- the areas and sequencing of the supporting work of the secretariat;

- requests for inputs from supervisory authorities and insurance companies of developing and developed countries, and from their insurance associations and institutions, as well as from representatives of international institutions;

- the possible setting up of expert groups.